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C O N F I D E N T I A L SECTION 01 OF 04 BAKU 000061

SIPDIS

E.O. 12958: DECL: 01/22/2019
TAGS: PGOV PREL AJ TU ENRG
SUBJECT: AZERBAIJAN: SOCAR CLAIMS TURKEY SEEKS TO BURY,
WHILE PRAISING, SOUTHERN CORRIDOR (CORRECTED COPY)

REF: A. A) BAKU 31
¶B. B) BAKU 1186 (2008)

Classified By: Amb. Anne E. Derse, Reasons 1.4 (b,d)

¶1. (C) SUMMARY. SOCAR is increasingly convinced Turkey is seeking to stop, not promote, the Southern Corridor project, in a quest to minimize the price it must pay for Azeri gas. Despite making what it feels are convincing political and commercial arguments to Turkey in support of the Southern Corridor, SOCAR feels Turkey seeks to maintain itself as a closed market and end point for Caspian gas, in order to better control the price and disposition of Caspian gas. SOCAR suggests that the EU should focus on encouraging Turkey to establish a commercially viable transit regime, as opposed to promoting individual pipeline projects. END SUMMARY.

¶2. (C) On January 19, Deputy Assistant Secretary of State for European and Eurasian Affairs Matthew Bryza met with SOCAR Marketing Vice-President Elshad Nasirov to discuss energy issues. EnergyOff was notetaker.

SOUTHERN CORRIDOR UPDATE

¶3. (C) In response to DAS Bryza's question as to recent Southern Corridor developments, Nasirov said SOCAR considers the next step in actualizing the Southern Corridor to be a bilateral 'gas transit memorandum' with Turkey that would lock in transit of seven bcm/a of Shah Deniz Phase Two (SD2) gas to Europe (COMMENT: SOCAR considers seven bcm/a as the minimum amount of gas needed to reach Europe to allow project financing for whichever pipeline project was to receive the gas. END COMMENT). No specific pipeline project would be mentioned in this MOU. Such a transit MOU with Turkey would allow the Shah Deniz (SD) Consortium to revive the currently stalled SD2 development and would serve to reassure both SD Consortium and potential investors as to the viability of SD2.

¶4. (C) Nasirov said that Turkey however sees the primary topic of any potential bilateral MOU to be Turkey's own energy security. It seeks a bilateral MOU guaranteeing eight bcm/a of SD2 for Turkey, despite the fact that such a high volume could well leave an insufficient amount of gas to sanction any of the competing pipeline projects

¶5. (C) Nasirov said the GOT is seeking to separate the two issues of price negotiations for the Shah Deniz Phase One (SD1) gas currently being supplied to Turkey, and the prospect of future SD2 gas sales. However, it was "the same gas, from the same field, traveling through the same pipeline to the same market," and as such "it made no sense" to talk

about two separate prices for SD1 and SD2.

¶6. (C) Additionally, in the face of BOTAS protestations that it would be willing to pay "fair market price" for SD2 gas, Nasirov has told the GOT that its continued price low-balling in negotiations over Shah Deniz Phase One (SD1) gas (ref A) show SOCAR that it is unwilling to consider such an option) if BOTAS wants to convince Azerbaijan it would pay "fair market price" for SD2, it should do so for SD1. Nasirov also told Bryza that the GOT focus on guaranteed volumes is pointless without considering price) "four versus eight bcm/a to Turkey has no commercial meaning unless price is considered." Nasirov explained to Bryza that Turkey seeks to prevent Azerbaijan from gaining direct access to European markets, as Ankara seeks to "impose" its own price on SD2 gas. What was needed was therefore a "small whole" in western Turkey that would allow Azerbaijan to transit some SD 2 gas to EU consumers who would contract directly with SOCAR.

ADVICE TO EU: UNIFY AND GO TO TURKEY

¶7. (C) Nasirov said his advice to the EU and its member states, to include his planned advice to EU Commissioner Benita Ferrara-Waldner during her upcoming Baku visit, was to stop fighting over promoting competing gas pipeline projects for the moment and to focus on getting a transparent and commercially viable gas transit regime through Turkey. After the GOT agrees to provide commercially viable gas transit, then ITGI, Nabucco and TAP and their relative EU sponsors can do battle for Caspian gas. Additionally, Nasirov said that "there is no need for the EU to reach out to Azerbaijan" on

energy, as Azerbaijan already was seeking to maximize its gas exports to Europe. Rather, the EU should focus its persuasive skills on getting Turkey to agree to allowing a minimum of seven bcm/a of SD2 gas to transit.

TWO TRANSIT ARGUMENTS

¶8. (C) Nasirov said SOCAR has been making two main arguments to Turkey in support of granting transit and opening the Southern Corridor: one commercial and one political. The commercial argument to Turkey in favor of SD2 gas transit relates to Turkey's need for "cheap gas." Currently the GOT's demand for gas is approximately 40 bcm/a. Nasirov said creating a commercially viable gas transit regime through Turkey would "pull" other and more Caspian gas to and through Turkey, up to as much as 100 bcm/a. Since Caspian gas producers would by definition get their best netbacks by selling to Turkey (since the transportation costs would be least) vice other markets downstream from Turkey, these Caspian gas producers , including Azerbaijan, would be competing with each other to supply gas to the Turkish market, resulting in higher volumes of potential gas for Turkey at lower prices. Gazprom and Iran would also have to lower its proffered gas price to Turkey in order to remain competitive. Turkey could thus ensure access to greater volumes of gas, and attract Azerbaijani gas to the higher netbacks it would enjoy in Turkey, by agreeing to a commercially attractive transit regime for the Southern Corridor across its territory.

¶9. (C) Additionally, SOCAR has argued to Turkey that it could earn substantial revenue on gas transiting to Europe. He said that Iraq, Iran, Turkmenistan, Kazakhistan, Uzbekistan and Azerbaijan itself could transit as much as as 100 bcm/a through Turkey in the short- to mid-term, generating massive transit revenue for Turkey. Nasirov said that the commercial argument doesn't sway Turkey, who sees the answer to its short-term energy needs in both locking up a minimum of eight bcm/a of SD2 gas and in the USG "telling Iraq" to provide its gas to Turkey.

¶10. (C) The second argument SOCAR seeks to make is the political one relating to the the clear political benefits of

allowing gas transit to Europe. Nasirov said there were three and only three non-Russian countries geographically located between Caspian energy producers and European energy consumers: Ukraine, Belarus and Turkey. Of these three, Turkey currently allows zero gas to transit to Europe. Turkey's strategic importance to Europe would be greatly magnified if it were to become a major transit country for Caspian gas, as Turkey could become "the most reliable" transit country for Caspian gas.

¶11. (C) Nasirov told Bryza a viable Southern Corridor would encourage Azerbaijan to seek to maximize its own (i.e. non-Shah Deniz) gas production in order to maximize exports. Until recently gas was cheaper than fuel oil (mazut) which meant that Azerbaijan sought to maximize gas use in its domestic dual-use power generation plants, while exporting fuel oil. However, now that fuel oil was cheaper than gas, Azerbaijan has decided to maximize its domestic use in order to potentially free up gas for export. By using four to five million tons of fuel oil in its power plants, Azerbaijan could potentially 'free up' an additional six to seven billion cubic meters of gas for export.

MOST RECENT MEETING

12 .(C) Nasirov told Bryza that a SOCAR delegation headed by President Rovnaq Abdullayev and himself met with "Prime Minister Erdogan's people" on January 16 in Turkey to ensure that the GOT understood the Azerbaijan position on Shah Deniz Phase Two (SD2) development (ref A). Although the "young people around Erdogan" say they understand the need to have gas transiting Turkey to Europe in order to establish a viable Southern Corridor, Nasirov said that all the Turkish government figures he meets "are competing to see who will be the one who delivers eight billion cubic meters annually (8 bcm/a) of Azerbaijani gas to Erdogan." As such, there was no progress during this meeting.

SOCAR DOWN ON GULER

¶13. (C) Nasirov said that SOCAR continued to think GOT Energy Minister Guler incapable of making a decision, which is why it sought a more direct channel with PM Erdogan (Reftel). According to Nasirov, during the November 14 meeting with Guler at SOCAR when Guler "had his pen out to sign" a bilateral transit MOU, BOTAS President Duzyol "reminded" Guler of Turkey's possible gas deficit, which was enough to prompt Guler to seek PM Erdogan's approval. Separately, Guler summoned SOCAR President Abdullayev and him to Turkey on December 5, saying he was "ready to sign" the bilateral MOU, only to back out again.

¶14. (C) Nasirov ciited Guler's approbatory comments on Turkey's gas market liberalization as hypocritical, given his insistence that Azerbaijan sell its gas to BOTAS and only BOTAS. Nasirov said that neither Guler nor Duzyol were "thinking strategically" or "long-term thinkers," although their focus on Turkey's short-term energy needs could well be a function of their desire to avoid jail, given the GOT propensity to imprison those responsible for commercially undesirable gas supply contracts. Nasirov saw PM Erdogan as "sharper" than Guler and with "more of a strategic vision; someone who takes the long-view."

GOT: NO SOUTHERN CORRIDOR

¶15. (C) An exasperated Nasirov concluded to Bryza that SOCAR has "tried everything" in its attempts to meet Turkey's professed energy supply concerns while also securing transit for seven bcm/a of SD2, to include offering Turkey a deal whereby it would sell SD2 to Turkey at whatever the price was of the current Gazprom-BOTAS contract, with a twenty percent discount, all to no avail. He now thinks that despite Turkey's public pro- Southern Corridor comments, Turkey

actually doesn't want any Caspian gas to transit to Europe, and its insistence on eight bcm/a is actually designed to "kill the Southern Corridor" (COMMENT: in a January 22 conversation with EnergyOff, Nasirov cited Erdogan's public comments linking Turkish Nabucco support to EU accession talks as further proof of Turkey's 'real' attitude toward the Southern Corridor. END COMMENT).

¶16. (C) In addition to the GOT's unwillingness to grant SD2 gas transit, Nasirov cited as further support of this thesis Turkey's unwillingness to accept the GOAJ proposal to "take over" the current BOTAS supply contract to Turkey for 750 mmcm/a. SOCAR has proposed, and the Greek energy company DEPA has accepted, a proposal whereby Azerbaijan would "take over" the existing BOTAS contract with DEPA for 0.75 bcm/a. Nasirov said that Turkey is losing approximately USD 220 million on this contract, given the disparity in the price it sells gas to Greece (USD 149/tcm) and the price it buys gas from Gazprom and Iran (an average of USD 420/tcm). By agreeing to the deal, BOTAS would save Turkey this USD 220 million subsidy to Greek consumers, while earning up to USD 29 million in transit fees. However, BOTAS refuses the deal, with Nasirov claiming that the reason is Turkey's desire to control all gas within its borders and its unwillingness to establish the principle of Azerbaijan selling gas to Europe through Turkey.

¶17. (C) Nasirov said President Aliyev would be attending the late January Nabucco summit in Hungary, "not in support of Nabucco per se, but in support of the Summit itself."

¶18. (C) COMMENT: Both SOCAR and President Aliyev have repeatedly expressed their frustration with Turkey over the transit talks, most recently with President Aliyev telling DAS Bryza that "we have already lost two years on Shah Deniz Phase II. I never could have believed that our closest friend would be blockading us and denying our access to Europe. This has created a lot of complications and I don't know what to do." (upcoming septel). SOCAR, the main driver of GOAJ energy policy, after "trying everything" to get transit, now seems to genuinely believe that it and Turkey are operating at cross-purposes, and therefore rightly or wrongly sees the only possibility for progress as more pressure on Turkey from the US and EU.

¶19. (C) COMMENT (CONT) The issue is not primarily one of volumes, since at least at one point SOCAR put a proposal that both provided eight bcm/a to Turkey and seven bcm/a for Europe, providing it could sell its gas at market price in

Turkey (Ref B). As such, as SOCAR itself has commented to Bryza, the issue is primarily one of price: SOCAR and the Shah Deniz Consortium are unwilling to provide gas to meet Turkey's professed energy security needs until and unless it can get a commercially viable price for so doing. SOCAR says it is willing to "leave money on the table" in order to get transit, as evidenced by its proposal to sell SD2 gas to Turkey at a price discounted down from the Gazprom/Iran price (i.e. Turkey's other gas suppliers). However, Turkey's refusal of this offer, and its unwillingness to contemplate paying a reasonable price for SD1, indicates to SOCAR at least that Turkey is willing to risk slowing and potentially losing the Southern Corridor in its desire to secure short-term gas at sub-market prices. END COMMENT.

¶20. (U) DAS Bryza has cleared this cable.
DERSE